

Let's get technical

This column is dedicated to answering questions submitted by members regarding Institute standards

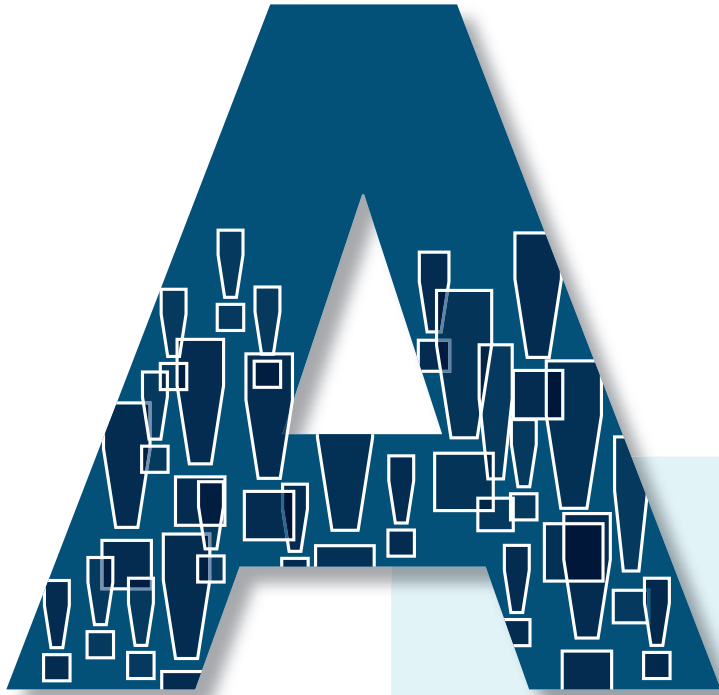
Q. Should deferred tax be provided for a change in fair value on financial assets classified as available-for-sale?

A. Paragraph 15 of HKAS 12 *Income Taxes* states that a deferred tax liability shall be recognized for all taxable temporary differences, except to the extent that the deferred tax liability arises from the initial recognition of goodwill, or the initial recognition of an asset or liability in a transaction, which is not a business combination and affects neither accounting profit nor taxable profit (tax loss) at the time of the transaction.

Paragraph 16 states that when the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability.

As set out in paragraph 55(b) of HKAS 39 *Financial Instruments: Recognition and Measurement*, a change in fair value of an available-for-sale financial asset shall be recognized directly in equity through the statement of changes in equity. If a tax balance arises on an available-for-sale asset, such a tax impact may be dealt with in equity instead of the income statement. It should be noted that paragraph 61 of HKAS 12 requires current tax and deferred tax shall be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

For example, an entity acquired an equity security for HK\$20,000 that is classified on



initial recognition as available-for-sale in accordance with HKAS 39. At the balance sheet date, the equity security's fair value increases to HK\$30,000 and the tax rate is 17.5 percent.

Thus, the change in fair value of the available-for-sale equity instrument of HK\$10,000 (that is, HK\$30,000–HK\$20,000) shall be charged directly to equity. In respect of related tax impact, depending on which tax jurisdiction an entity is operating in, a current (if tax on the gain is payable in the current period) or a deferred tax liability (if tax on the gain is payable until the investment is sold) of HK\$1,750 (that is 17.5 percent of HK\$10,000) will be recognized at the balance sheet date with a corresponding debit to equity.

When that available-for-sale equity instrument is eventually sold in the subsequent financial period, the gain or loss that has been recognized in equity is recycled through profit or loss. This includes those tax effects previously recognized in equity, which is reversed in the same period as the gains or losses to which they relate.

Members helping members

Try answering this question from a member and send an email to hkicpa@hkicpa.org.hk. Answers received by 18 September will be considered for inclusion in the November issue of A Plus.

Q. After my company issued a compound financial instrument, it seems to me that the exercise of the conversion option would be more advantageous to holders. In this respect, should the classification of the liability and equity of a compound financial instrument be revised if there is a change in the likelihood that a conversion option will be exercised in a subsequent accounting period?

Here is the answer to the question we asked members to help with in the July 2008 edition of A Plus:

Q. I understand that HKAS 1 (revised) *Presentation of Financial Statements* is effective for annual periods beginning on or after 1 January 2009 with earlier application permitted. In relation to HKAS 1 (revised), I note that a “balance sheet” is now referred to as a “statement of financial position,” and a “cash flow statement” is referred to as a “statement of cash flows.” Furthermore, HKAS 1 (revised) introduces the statement of comprehensive income. However, I note that these new titles are not mandatory for use in financial statements. What is your recommendation?

A. You are correct. Entities can choose whether to use the new titles or not. Given that the new titles will be used in all financial reporting standards from now on, we would recommend that you adopt the new titles in your financial statements for simplicity and comparability going forward.

You can submit questions on technical issues by sending an email to hkicpa@hkicpa.org.hk. The standard setting team will answer these questions in accordance with the policy on handling members' technical questions which is posted on the Institute's website.